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DON'T LET SUCCESSION PLANNING FAIL

Does this scenario seem familiar? You finally convinced the owner of a thriving family business to tackle a succession plan for the business. You designed a detailed plan to satisfy his stated objectives with maximum tax efficiency, but when you met to review the plan, the owner didn't share your enthusiasm. He agreed that each step seemed logical, but left the meeting without committing to put the plan into action.

Many business succession plans are never implemented, in spite of a motivated client, a competent attorney, and a tax-efficient plan that seems to address the client's needs. This is often the result of issues which, if ignored, can undermine the effectiveness of the CPA's service.

There are three common reasons why CPAs create succession plans that cannot succeed:

- ☐ Confusion over who is the client.
- ☐ Biases, stemming from the CPA's own stage in life and personal experiences.
- ☐ Reluctance to put the client relationship at risk by bringing up taboo subjects.

CPAs also tend to overlook opportunities to provide billable services that help the family and the business prepare for transition. Careful consideration of these factors can help turn proposed plans into successful transitions and assist in retaining the client.

Who is the client?

Players in the succession planning process include the business itself, the owners, and the successors, who typically are the children of the owners, but who also might be a group of nonfamily key executives. But which one is the client? Is it the family business owner, whom you may have been serving for ten or twenty years? Is it the successors, who may or may not consider you to be their business advisor? Or is it the business itself? Ignoring this potential conflict of interest can doom a succession plan, no matter how sound it is.

This wasn't an issue before succession planning began. In fact, you may have prepared income tax returns for the business, the owners, and the probable successors with no problems at all. But then, you knew who the primary client was. It was the owner who made all the important decisions for the business. Once succession planning begins, however, serving diverse constituents becomes complicated. Should your role be to protect the interests of the owners as they think of retiring, should it be to preserve the viability of the business, or should it be to get the best possible deal for the successors?

The sage advice a CPA would give to aging owners may not serve the business' best interests. An accountant who considers the sixty-five-year-old family business owner to be the primary client might recommend an all-cash transaction, to minimize the client's risk. That advice probably would rule out a redemption, however, and rarely do the children of a family business owner have the personal wealth or borrowing power to pay their parents in cash.

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What's Inside . . .

PCPS Advocacy Activities

TIC meets with standard setters

In September, the technical issues committee (TIC) of the private companies practice section of the AICPA division for CPA firms held its annual meeting with the Financial and Governmental Accounting Standards Boards (FASB/GASB) to discuss areas in which TIC can provide constructive assistance in developing standards that take into consideration small business and small government environments.

Last year, FASB asked TIC to let it know of areas in which small community bankers had difficulty implementing the new statement of financial accounting standards, no. 107, *Disclosures About Fair Value of Financial Instruments*. Now that the standard has been applied for the first time to year-end financial statements, TIC was able to provide actual examples from practice of such implementation difficulties. FASB plans to review how CPAs apply the new standard to see where added guidance might be helpful.

FASB questioned TIC on the impact the proposal, *Accounting for Stock-Based Compensation*, might have on small businesses. FASB suggested TIC field-test the computations on various existing plans to which the proposed standard would apply, and provide the Board with the results.

FASB also asked TIC to explain in detail its comments on the proposed statement of position (SOP), *Disclosure of Certain Significant Risks and Uncertainties and Financial Flexibility*. (See "Proposed SOP Affects Your Practice," *Practicing CPA*, May, 1993, p. 6., and "PCPS Advocacy Activities," *Practicing CPA*, August 1993, p. 2.) FASB must approve the final draft of the SOP before it can be issued, and wanted to be sure it understood the potential impact on small entities.

In its meeting with the GASB chairman, TIC expressed concern over the Board's development of different standards for governmental activities that are substantially identical to commercial enterprises. TIC stated its preference for applying for-profit generally accepted accounting principles to governmental proprietary activities to the extent possible, as part of its ongoing effort to reduce standards overload. ☑

1994 PCPS Conference Announced

The 1994 Private Companies Practice Section National Conference will be held on May 1–4 at the Sheraton Bal Harbor Resort near Ft. Lauderdale, Florida. A new feature planned is an "Association Fair," where participants can meet representatives of professional associations.

Technical sessions

The partner-level program offers sessions on the latest technical and management issues, including taking the offense against malpractice through alternative dispute resolution (ADR), a special forum on sole-owner issues, practical uses for technology, sexual harassment charges (if you think you are immune, think again), tax strategies for client divorce, aging clients and ownership transfers, living with the new "Yellow Book," innovative ways to communicate financial data, not-for-profit update, balancing audit risk and efficiency, and partner/shareholder issues.

Social activities

Besides golf, the hotel's on-the-beach location caters to family social activities — beach olympics, fun runs, volleyball, fishing, sailing and more. You can even end your spring break with an optional sail to the Caribbean on a luxury cruise ship.

Following the PCPS conference, the Florida Institute of Certified Public Accountants offers, for a separate fee, a two-day course, "How to Conduct a Review Under the AICPA Practice Monitoring Programs."

Have your name added to the special mailing list so you don't miss the brochure with its discount for early registration. Just call (800) CPA-FIRM.

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Highlights of Recent Pronouncements

FASB Statements of Financial Accounting Standards

No. 117 (June 1993), *Financial Statements of Not-for-Profit Organizations*

- ☐ Amends FASB Statement no. 95, *Statement of Cash Flows*, to:
  1) Extend its provisions to not-for-profit organizations;
  2) Expand its description of cash flows from financing activities to include certain donor-restricted cash that must be used for long-term purposes.
- ☐ Establishes standards for general-purpose external financial statements provided by a not-for-profit organization.
- ☐ Requires:
  1) That those financial statements provide certain basic information that focuses on the entity as a whole and meets the common needs of external users of those statements;
  2) That all not-for-profit organizations provide a statement of financial position, a statement of activities, and a statement of cash flows;
  3) Reporting amounts for the organization's total assets, liabilities, and net assets in a statement of financial position; reporting the change in an organization's net assets in a statement of activities; and reporting the change in its cash and cash equivalents in a statement of cash flows;
  4) Classification of an organization's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions;
  5) That the amounts for each of three classes of net assets—permanently restricted, temporarily restricted, and unrestricted—be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities;
  6) That voluntary health and welfare organizations provide a statement of functional expenses that reports expenses by both functional and natural classifications.
- ☐ Effective for annual financial statements issued for fiscal years beginning after December 15, 1994. Effective for organizations with less than $5 million in total assets and less than $1 million in annual expenses for fiscal years beginning after December 15, 1995. Earlier application is encouraged.

No. 116 (June 1993), *Accounting for Contributions Received and Contributions Made*

- ☐ Establishes accounting standards for contributions.
- ☐ Applies to all entities that receive or make contributions.
- ☐ Requires:
  1) Not-for-profit organizations to distinguish between contributions received that increase permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets;
  2) Recognition of the expiration of donor-imposed restrictions in the period in which the restrictions expire;
  3) Certain disclosures for collection items not capitalized and for receipts of contributed services and promises to give.
- ☐ Allows certain exceptions for contributions of services and works of art, historical treasures, and similar assets.
- ☐ Effective for financial statements issued for fiscal years beginning after December 15, 1994. Effective for not-for-profit organizations with less than $5 million in total assets and less than $1 million in annual expenses for fiscal years beginning after December 15, 1995. Earlier application is encouraged.

No. 115 (May 1993), *Accounting for Certain Investments in Debt and Equity Securities*

- ☐ Supersedes FASB Statement no. 12, *Accounting for Certain Marketable Securities*, and related Interpretations.
- ☐ Amends FASB Statement no. 65, *Accounting for Certain Mortgage Banking Activities*, to eliminate mortgage-backed securities from its scope.
- ☐ Amends numerous other accounting pronouncements.
- ☐ Addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities.
- ☐ Effective for fiscal years beginning after December 15, 1993.

No. 114 (May 1993), *Accounting by Creditors for Impairment of a Loan.*

- ☐ Supersedes and amends certain FASB Statements and Technical Bulletins.
- ☐ Requires that impaired loans that are within the scope of this Statement be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

☐ Effective for financial statements for fiscal years beginning after December 15, 1994. Earlier application is encouraged.

GASB Statements of the Governmental Accounting Standards Board

No. 20 (September 1993), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*

☐ Amends National Council on Governmental Accounting Statement 1, *Governmental Accounting and Financial Reporting Principles.*

☐ *Provides interim guidance on business-type accounting and financial reporting for proprietary activities, pending further GASB research that is expected to lead to the issuance of one or more pronouncements on the accounting and financial reporting model for proprietary activities.*

☐ *Applies to accounting and financial reporting for proprietary activities—that is, proprietary funds and other governmental entities that use proprietary fund accounting, including public benefit corporations and authorities, governmental utilities, and governmental hospitals and other healthcare providers.*

☐ *Effective for financial statements for periods beginning after December 15, 1993. Earlier application is encouraged.*

No. 19 (September 1993), Governmental College and University Omnibus Statement

☐ Amends GASB Statement nos.:

1) 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues;*
2) 15, *Governmental College and University Accounting and Financial Reporting Models.*

☐ Provides guidance on the appropriate fund group classification for Pell grants and on risk financing activities reported in a single fund by governmental colleges and universities that follow the AICPA College Guide model, as described in Statement no. 15.

☐ Requires governmental colleges and universities that follow the AICPA College Guide model to report Pell grants in a restricted current fund.

☐ Requires that if a single fund is used to account for risk financing activities, that fund should be reported as an unrestricted current fund.

☐ For Pell grants, this Statement is effective for financial statements for periods beginning after June 15, 1993. For risk financing activities, this Statement is effective for financial statements for periods beginning after June 15, 1994. Earlier application is encouraged.

No. 18 (August 1993), *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*

☐ Establishes standards of accounting and financial reporting for municipal solid waste landfill (MSWLF) closure and postclosure care costs that are required to be incurred by federal, state, or local laws or regulations.

☐ Applies to state and local governmental entities that are required by federal, state, or local laws or regulations to incur MSWLF closure and postclosure costs.

☐ Effective for financial statements for periods beginning after June 15, 1993. Earlier application is encouraged.

No. 17 (June 1993), *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements: Amendment of the Effective Dates of GASB Statement No. 11 and Related Statements*

☐ Amends GASB Statement nos.:

1) 11, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements,* to defer the effective date to periods beginning approximately two years after an implementation standard is issued;
2) 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* to establish an effective date for entities other than pools using the modified accrual basis of accounting in governmental and similar trust funds that is independent of the effective date of Statement no. 11;
3) 13, *Accounting for Operating Leases with Scheduled Rent Increases,* to modify the reference to Statement no. 11's effective date.

☐ Effective upon issuance.

Statement on Standards for Attestation Engagements

No. 2 (May 1993), *Reporting on an Entity's Internal Control Structure Over Financial Reporting*

☐ Supersedes Statement on Auditing Standards (SAS) no. 30, *Reporting on Internal Accounting Control.*

☐ Provides guidance to the practitioner who is engaged to examine and report on management's written assertion about the effectiveness of an entity's internal control structure over financial reporting as of a point in time.

☐ Effective for an examination of management's assertion on the effectiveness of an entity's internal control structure over financial reporting when the assertion is as of December 15, 1993, or thereafter. Earlier application is encouraged.

Your Voice in Washington

AICPA urges Congress to reject proposals to amend new tax law

In recent testimony, the American Institute of Certified Public Accountants urged Congress to reject more than eighty proposals under its consideration that would amend the new tax law signed by President Clinton this summer.

The AICPA emphasized in its testimony that many of the items "would impose burdens completely disproportionate" to the small amount of revenues the proposals would raise. Furthermore, the AICPA pointed out that the changes being considered before the provisions of the Omnibus Budget Reconciliation Act of 1993 have taken effect and that change, in and of itself, is a source of complexity. Congress must be ever mindful of "inordinate complexity and reporting burdens" because of the adverse effects these factors have on compliance by taxpayers, the AICPA said.

Among the proposals before the House Ways and Means Subcommittee on Select Revenue Measures is one that would amend the individual estimated tax provisions of the 1993 Act (see the September 1993 *Practicing CPA*). Under the proposal, the new safe harbor would be increased from 110 percent to 115 percent for individuals who have adjusted gross incomes exceeding $150,000 and who are required to make estimated tax payments. The AICPA warned the subcommittee that at 115 percent, many taxpayers would not use the safe harbor. These taxpayers would be faced "instead" with more complex calculations three or four times a year.

It's not clear how great a threat this proposal actually poses to the new 1993 estimated tax law, but after all the hard work by the AICPA and its members to have the onerous 1991 estimated tax rules repealed and a workable safe harbor restored, the AICPA is committed to doing everything possible to prevent the 1993 law from being amended.

A "worrisome theme" noted among the proposals by the AICPA is the growing tendency to chip away at the net income concept of taxation by disallowing portions of bona fide trade or business expenses. The testimony identified the following proposals as representative of this approach: disallowing a portion of advertising expenses; disallowing a deduction for corporate interest on tax underpayments; limiting deductions for valid business auto expenses; and denying the deduction for environmental clean-up costs and damages.

The AICPA also opposed two other proposals—replacement of the foreign tax credit with a deduction and repeal of the taxable income limit for the S Corporation built-in-gains tax. ☑

Conference Calendar

National Conference on Federal Taxes
November 1–2—Grand Hyatt, Washington, DC
Recommended CPE credit: 16 hours

National Conference on Banking
November 4–5—Grand Hyatt, Washington, DC
Recommended CPE credit: 19 hours

Credit Unions Conference
November 8–9—Las Vegas Hilton, Las Vegas, NV
Recommended CPE credit: 16 hours

IRS National Office—Tax Practitioners Technical Roundtable*
November 12–13—Capital Hilton, Washington, DC
Recommended CPE credit: 13 hours

Annual Conference on the Securities Industry
November 17–18—Javits Center, New York, NY
Recommended CPE credit: 16 hours

National Construction Conference
December 6–7—Sheraton New Orleans, New Orleans, LA
Recommended CPE credit: 16 hours

Fall Tax Division Meeting
December 6–8—New Orleans Mariott, New Orleans, LA
Recommended CPE credit: 8 hours

Personal Financial Planning Technical Conference*
January 10–12—The Hyatt Regency Westshore, Tampa, FL
Recommended CPE credit: 21 hours

Conference on Current SEC Developments*
January 11–12—Grand Hyatt, Washington, DC
Recommended CPE credit: 16 hours

To register or for more information, call the AICPA CPE division, (800) 862-4272.

*Call the AICPA meetings and travel department, (201) 938-3232.

Succession Planning
(continued from page 1)

If the business is the client, a redemption plan with a small down payment and a long-term installment note might fit the cash flow of the business. But the successors might see that the plan would leave them forever indebted to their parents, and a sizeable note on the company's balance sheet could restrict its borrowing power.

The CPA who wants to retain the client after the transition could see the successors as the client, and might recommend that the parents gift their stock outright to their children. Parent-owners typically cannot afford to give away their most valuable asset, however, and don't want to pay gift tax. In addition, gifts do not test the children's commitment to the business, and often come with strings attached. Given these conflicting issues, where should you focus?

Experience has taught that the primary client must be the business itself. Business succession planning assumes that the ability of the business to flourish in the future generates opportunities for the family and, therefore, is in the best interests of the owners and the successors.

Succession requires change, and people often resist change. Your challenge is to present change in a way that protects all the interests. It certainly is possible to structure a plan that both addresses the owners' and successors' financial and emotional concerns and fosters the survival of the business. For example, an installment sale transaction can have default provisions to guard against an erosion in the company's financial health. Such provisions protect the seller and encourage the transition.

Both selling to a third party or keeping the business for successors appear to require sacrifice by the seller. Selling out may provide the owners with a considerable amount of money, but selling a multigenerational business can be a tremendous blow to family unity and identity. On the other hand, transferring to successors may seem a sacrifice in terms of cash and financial security. If the owners and successors can agree to make small, personal compromises, with the overriding goal of the long-term health of the business being paramount, then a successful plan can be created. Clients should be willing to subordinate their self-interest for the sake of the business and the family.

How do your biases affect the plan?

Just as an aging owner and a young successor have conflicting attitudes about risk and other issues, an advisor's age and career stage will predispose him or her to certain biases about succession planning. These biases, if not addressed, can interfere with a client's successful transition.

For instance, young CPAs, who are years away from retirement, may not be sensitive to the aging owners' emotions and needs. Older accountants, who may be grappling with their own succession issues, may be more inclined to focus on the owner-client's need for security and recommend selling the business to a third party, or worse, dealing with succession through a will or living trust.

Holding on to the business until death is risky for the family (even if the owner has a will or living trust). When a succession plan is death-driven, the ownership transfer may be delayed until the beneficiaries are themselves in their fifties or sixties. That is not an ideal time for successors to take on an entrepreneurial challenge and keep the business growing. A testamentary transfer often results in the business ultimately being sold — to pay off estate taxes, to resolve family conflict, or just because the successors are ready to retire.

But aging owners often find it difficult to let go of the business for many reasons, not the least of which is that life expectancy is increasing. The National Institute of Mental Health projects that in the next century, the average life expectancy will be eighty-five. If the owners retire at age sixty or sixty-five, they potentially would have twenty or twenty-five post-retirement years ahead of them — fully a fourth of their lives. Letting go of the business would require them to find a secure stream of income to provide for those years, as well as meaningful activities to fill their days.

Reluctance can also stem from modern-day complications in family makeup. Today we have single parents, step-parents, step-children, half siblings, caretakers, and caregivers. Result: Selecting a successor isn't easy (if it ever was). What happens when the step-children are more competent than the blood line? Or when adopted children are better leaders than the biological children? These are difficult decisions to make. Not confronting these issues deprives everyone of opportunities.

Advisors cannot assume that the options which appear most attractive to them at their present stage of life are the appropriate solutions for the client. It is critical for you as the CPA to take account of your own biases so they don't cloud your clients' decisions.

How do you address sensitive issues affecting the plan?

An owner's interest in preserving the business permits you — in fact, requires you — to raise challenging questions, some of which may be taboo in the family. For instance, are the chosen successors competent and ready to assume ownership and management of the company? Is the current owner willing and prepared to let go of the reins? Will children who do not work at the company receive an equal ownership share? What are the expectations about who will own the company? What's the long-term view and what are the expectations about who will make day-to-day operating decisions for the company?

Avoiding such issues is often the biggest obstacle to implementing succession plans. While the owner probably has made strategic business decisions unilaterally in the past, that won't work when it comes to transition decisions. When the parents make decisions that affect their children's future without involving these same children (and their spouses) in the process, and the younger people don't like those decisions, chances are the plan will never be implemented.

If you're not comfortable bringing these issues to the table, you should find someone who is. In order to keep the business in the family, the family will have to deal with its emotional business. Experts who facilitate family transitions can help.

Of course, conflicts will arise, but conflicts aren't the problem. It's the reaction to conflict that usually causes a problem. Conflict gives people an opportunity to learn to manage their differences. Many CPAs worry that if they don't side with the owner — their long-term client — they will lose that client. But the truth is, failing to help all the business stakeholders tackle conflicts will likely result in the succession plan's failing. That can result in a failed business or a third-party sale. Either way, you lose the client.

Consider, instead, taking the position of representing "the business." You may offend the owners and lose the client, but, more likely, you will help them align their thinking, which in turn, will help them preserve the business for the next generation or for key employees. As a result, you may have an ongoing relationship — and one that's stronger, at that.

Don't overlook a profitable opportunity

As a CPA, you should look into developing new value-added services (and sources of revenue) from present clients. After all, as more and more post-World War II entrepreneurs approach retirement, your client base may be dwindling. The more clients avoid following through with succession plans, the more likely it becomes that their businesses will ultimately be sold or liquidated. The more likely, then, that you will need to spend time marketing to generate new business. So in addition to marketing for new clients, you should be scouting for more and continued business from your existing client base.

One valuable service is to help the next generation and/or key nonfamily executives develop a comprehensive plan to keep the business independent. A transaction can be structured to match the price available from outside parties, and to reduce the risk and sacrifice for owners considering selling the business to them.

You can also help the next generation articulate its vision and mission for the family business and act as mentor to educate successors about the financial requirements of running the business. You can work out cash-flow projections that predict what the business will look like under certain conditions and, by doing so, provide services the client appreciates. This will help you build a stronger relationship with the successors.

Don't let your clients' succession plans fail because you didn't deal with sensitive issues that are within your control. You can provide a valued service to family business clients and enhance your client retention on a basis that is profitable both to them and to you. ☑

— by **Mike Cohn,** *The Cohn Financial Group, Inc., 5080 North 40th Street, Suite 235, Phoenix, Arizona 85018, tel. (602) 468-9667*

Editor's note: The above article is adapted from a presentation Mr. Cohn gave at this year's PCPS conference in San Diego. Mr. Cohn is the author of Passing the Torch: Succession, Retirement, & Estate Planning in Family-Owned Businesses *(New York: McGraw Hill, 1992). To purchase the book (discount cost to AICPA members, $15), call (800) 422-3883.*

Socials: Good Networking Opportunities

One way to increase the number of referrals you receive is to arrange a social activity with other referring organizations. For a CPA firm, such arrangements would be made with banks, law firms, and other professional service organizations.

While "socials" provide opportunities to meet key players of the various organizations and the chance to learn more about each other's capabilities and areas of focus, the primary purpose is to allow individuals with certain affinities to meet one another in order to develop ongoing relationships. This might seem rather obvious, but, too often, meaningful follow-up just never happens. Following are some steps you might take to make your socials more successful:

- ☐ Obtain lists from the other participating organizations, showing who will be attending, their respective positions and responsibilities in those firms, and their areas of expertise.
- ☐ Distribute the attendance list to the individuals in your firm who will be participating, and suggest preliminary pairings based on criteria such as position in the firm, same clients, common areas of expertise and specialization, and similar ages and personal interests.
- ☐ Remind your participants that the basic objective is to make initial contacts that will develop into ongoing relationships.
- ☐ During the social, your representatives should listen for opportunities that will allow your firm to both offer help to and receive help from other participants.
- ☐ Shortly after the social, your participants should meet to share information and decide who is best suited to cultivate relationships with specific individuals from the other organizations.
- ☐ Set guidelines for follow-up activities. For example, you might require participants to meet with their counterparts at the other organizations during the two weeks following the event, and to maintain regular contact thereafter.
- ☐ As a gesture of goodwill, be prepared to make worthwhile referrals to the other organizations as soon as possible.

When you take actions such as those described above, your socials can become productive, low-cost marketing initiatives. Furthermore, these steps should make socials particularly effective in situations where your firm has limited or no personal contacts in other referring organizations. ☑

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